

granted for transporting oil taken as Royalty-In-Kind (RIK); or

(b)(1) Except as provided in paragraph (b)(2) of this section, the transportation allowance deduction on the basis of a selling arrangement shall not exceed 50 percent of the value of the oil at the point of sale as determined under §206.52 of this subpart. Transportation costs cannot be transferred between selling arrangements or to other products.

(2) Upon request of a lessee, MMS may approve a transportation allowance deduction in excess of the limitation prescribed by paragraph (b)(1) of this section. The lessee must demonstrate that the transportation costs incurred in excess of the limitation prescribed in paragraph (b)(1) of this section were reasonable, actual, and necessary. An application for exception (using Form MMS-4393, Request to Exceed Regulatory Allowance Limitation) shall contain all relevant and supporting documentation necessary for MMS to make a determination. Under no circumstances shall the value, for royalty purposes, under any selling arrangement, be reduced to zero.

(c) Transportation costs must be allocated among all products produced and transported as provided in §206.55. Transportation allowances for oil shall be expressed as dollars per barrel.

(d) If, after a review and/or audit, MMS determines that a lessee has improperly determined a transportation allowance authorized by this subpart, then the lessee shall pay any additional royalties, plus interest determined in accordance with 30 CFR 218.54, or shall be entitled to a credit, without interest.

§206.55 Determination of transportation allowances.

(a) *Arm's-length transportation contracts.* (1)(i) For transportation costs incurred by a lessee under an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting oil under that contract, except as provided in paragraphs (a)(1)(ii) and (a)(1)(iii) of this section, subject to monitoring, review, audit, and adjustment. The lessee shall have the burden

of demonstrating that its contract is arm's-length. Such allowances shall be subject to the provisions of paragraph (f) of this section. Before any deduction may be taken, the lessee must submit a completed page one of Form MMS-4110 (and Schedule 1), Oil Transportation Allowance Report, in accordance with paragraph (c)(1) of this section. A transportation allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4110 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee.

(ii) In conducting reviews and audits, MMS will examine whether the contract reflects more than the consideration actually transferred either directly or indirectly from the lessee to the transporter for the transportation. If the contract reflects more than the total consideration, then MMS may require that the transportation allowance be determined in accordance with paragraph (b) of this section.

(iii) If MMS determines that the consideration paid under an arm's-length transportation contract does not reflect the reasonable value of the transportation because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then MMS shall require that the transportation allowance be determined in accordance with paragraph (b) of this section. When MMS determines that the value of the transportation may be unreasonable, MMS will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's transportation costs.

(2)(i) If an arm's-length transportation contract includes more than one liquid product, and the transportation costs attributable to each product cannot be determined from the contract, then the total transportation costs shall be allocated in a consistent and equitable manner to each of the liquid products transported in the same proportion as the ratio of the volume of each product (excluding waste products which have no value) to the volume of all liquid products (excluding waste

products which have no value). Except as provided in this paragraph, no allowance may be taken for the costs of transporting lease production which is not royalty-bearing without MMS approval.

(ii) Notwithstanding the requirements of paragraph (i), the lessee may propose to MMS a cost allocation method on the basis of the values of the products transported. MMS shall approve the method unless it determines that it is not consistent with the purposes of the regulations in this part.

(3) If an arm's-length transportation contract includes both gaseous and liquid products, and the transportation costs attributable to each product cannot be determined from the contract, the lessee shall propose an allocation procedure to MMS. The lessee may use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all available data to support its proposal. The initial proposal must be submitted by June 30, 1988 or within 3 months after the last day of the month for which the lessee requests a transportation allowance, whichever is later (unless MMS approves a longer period). MMS shall then determine the oil transportation allowance based upon the lessee's proposal and any additional information MMS deems necessary.

(4) Where the lessee's payments for transportation under an arm's-length contract are not on a dollar-per-unit basis, the lessee shall convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(5) Where an arm's-length sales contract price, or a posted price, includes a provision whereby the listed price is reduced by a transportation factor, MMS will not consider the transportation factor to be a transportation allowance. The transportation factor may be used in determining the lessee's gross proceeds for the sale of the product. The transportation factor may not exceed 50 percent of the base price of the product without MMS approval.

(b) *Non-arm's-length or no contract.* (1) If a lessee has a non-arm's-length transportation contract or has no contract, including those situations where the lessee performs transportation services for itself, the transportation allowance will be based upon the lessee's reasonable, actual costs as provided in this paragraph. All transportation allowances deducted under a non-arm's-length or no-contract situation are subject to monitoring, review, audit, and adjustment. Before any estimated or actual deduction may be taken, the lessee must submit a completed Form MMS-4110 in its entirety in accordance with paragraph (c)(2) of this section. A transportation allowance may be claimed retroactively for a period of not more than 3 months prior to the first day of the month that Form MMS-4110 is filed with MMS, unless MMS approves a longer period upon a showing of good cause by the lessee. MMS will monitor the allowance deductions to determine whether lessees are taking deductions that are reasonable and allowable. When necessary or appropriate, MMS may direct a lessee to modify its actual transportation allowance deduction.

(2) The transportation allowance for non-arm's-length or no-contract situations shall be based upon the lessee's actual costs for transportation during the reporting period, including operating and maintenance expenses, overhead, and either depreciation and a return on undepreciated capital investment in accordance with paragraph (b)(2)(iv)(A) of this section, or a cost equal to the initial capital investment in the transportation system multiplied by a rate of return in accordance with paragraph (b)(2)(iv)(B) of this section. Allowable capital costs are generally those for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.

(i) Allowable operating expenses include: Operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: Maintenance of the transportation system; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(iv) A lessee may use either depreciation or a return on depreciable capital investment. After a lessee has elected to use either method for a transportation system, the lessee may not later elect to change to the other alternative without approval of MMS.

(A) To compute depreciation, the lessee may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the transportation system services or on a unit-of-production method. After an election is made, the lessee may not change methods without MMS approval. A change in ownership of a transportation system shall not alter the depreciation schedule established by the original transporter/lessee for purposes of the allowance calculation. With or without a change in ownership, a transportation system shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

(B) MMS shall allow as a cost an amount equal to the initial capital investment in the transportation system multiplied by the rate of return determined under paragraph (b)(2)(v) of this section. No allowance shall be provided for depreciation. This alternative shall apply only to transportation facilities first placed in service after March 1, 1988.

(v) The rate of return shall be the industrial rate associated with Standard and Poor's BBB rating. The rate of return shall be the monthly average rate as published in Standard and Poor's Bond Guide for the first month of the reporting period for which the allowance is applicable and shall be effective during the reporting period. The rate shall be redetermined at the beginning

of each subsequent transportation allowance reporting period (which is determined under paragraph (c) of this section).

(3)(i) The deduction for transportation costs shall be determined on the basis of the lessee's cost of transporting each product through each individual transportation system. Where more than one liquid product is transported, allocation of costs to each of the liquid products transported shall be in the same proportion as the ratio of the volume of each liquid product (excluding waste products which have no value) to the volume of all liquid products (excluding waste products which have no value) and such allocation shall be made in a consistent and equitable manner. Except as provided in this paragraph, the lessee may not take an allowance for transporting lease production which is not royalty-bearing without MMS approval.

(ii) Notwithstanding the requirements of paragraph (i), the lessee may propose to MMS a cost allocation method on the basis of the values of the products transported. MMS shall approve the method unless it determines that it is not consistent with the purposes of the regulations in this part.

(4) Where both gaseous and liquid products are transported through the same transportation system, the lessee shall propose a cost allocation procedure to MMS. The lessee may use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all available data to support its proposal. The initial proposal must be submitted by June 30, 1988 or within 3 months after the last day of the month for which the lessee requests a transportation allowance, whichever is later (unless MMS approves a longer period). MMS shall then determine the oil transportation allowance on the basis of the lessee's proposal and any additional information MMS deems necessary.

(5) A lessee may apply to MMS for an exception from the requirement that it compute actual costs in accordance with paragraphs (b)(1) through (b)(4) of

this section. MMS will grant the exception only if the lessee has a tariff for the transportation system approved by the Federal Energy Regulatory Commission (FERC) for Indian leases. MMS shall deny the exception request if it determines that the tariff is excessive as compared to arm's-length transportation charges by pipelines, owned by the lessee or others, providing similar transportation services in that area. If there are no arm's-length transportation charges, MMS shall deny the exception request if:

(i) No FERC cost analysis exists and the FERC has declined to investigate under MMS timely objections upon filing; and

(ii) the tariff significantly exceeds the lessee's actual costs for transportation as determined under this section.

(c) *Reporting requirements.* (1) *Arm's-length contracts.* (i) With the exception of those transportation allowances specified in paragraphs (c)(1)(v) and (c)(1)(vi) of this section, the lessee shall submit page one of the initial Form MMS-4110 (and Schedule 1), Oil Transportation Allowance Report, prior to, or at the same time as, the transportation allowance determined, under an arm's-length contract, is reported on Form MMS-2014, Report of Sales and Royalty Remittance. A Form MMS-4110 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received.

(ii) The initial Form MMS-4110 shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier.

(iii) After the initial reporting period and for succeeding reporting periods, lessees must submit page one of Form MMS-4110 (and Schedule 1) within 3 months after the end of the calendar year, or after the applicable contract or rate terminates or is modified or amended, whichever is earlier, unless MMS approves a longer period (during which period the lessee shall continue

to use the allowance from the previous reporting period).

(iv) MMS may require that a lessee submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(v) Transportation allowances which are based on arm's-length contracts and which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) MMS may establish, in appropriate circumstances, reporting requirements which are different from the requirements of this section.

(2) *Non-arm's-length or no contract.* (i) With the exception of those transportation allowances specified in paragraphs (c)(2)(v), (c)(2)(vii) and (c)(2)(viii) of this section, the lessee shall submit an initial Form MMS-4110 prior to, or at the same time as, the transportation allowance determined under a non-arm's-length contract or no-contract situation is reported on Form MMS-2014. A Form MMS-4110 received by the end of the month that the Form MMS-2014 is due shall be considered to be timely received. The initial report may be based upon estimated costs.

(ii) The initial Form MMS-4110 shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a transportation allowance and shall continue until the end of the calendar year, or until transportation under the non-arm's-length contract or the no-contract situation terminates, whichever is earlier.

(iii) For calendar-year reporting periods succeeding the initial reporting period, the lessee shall submit a completed Form MMS-4110 containing the actual costs for the previous reporting period. If oil transportation is continuing, the lessee shall include on Form MMS-4110 its estimated costs for the next calendar year. The estimated

oil transportation allowance shall be based on the actual costs for the previous reporting period plus or minus any adjustments which are based on the lessee's knowledge of decreases or increases that will affect the allowance. MMS must receive the Form MMS-4110 within 3 months after the end of the previous reporting period, unless MMS approves a longer period (during which period the lessee shall continue to use the allowance from the previous reporting period).

(iv) For new transportation facilities or arrangements, the lessee's initial Form MMS-4110 shall include estimates of the allowable oil transportation costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the transportation system or, if such data are not available, the lessee shall use estimates based upon industry data for similar transportation systems.

(v) Non-arm's-length contract or non-contract transportation allowances which are in effect at the time these regulations become effective will be allowed to continue until such allowances terminate. For the purposes of this section, only those allowances that have been approved by MMS in writing shall qualify as being in effect at the time these regulations become effective.

(vi) Upon request by MMS, the lessee shall submit all data used to prepare its Form MMS-4110. The data shall be provided within a reasonable period of time, as determined by MMS.

(vii) MMS may establish, in appropriate circumstances, reporting requirements which are different from the requirements of this section.

(viii) If the lessee is authorized to use its FERC-approved tariff as its transportation cost in accordance with paragraph (b)(5) of this section, it shall follow the reporting requirements of paragraph (c)(1) of this section.

(3) MMS may establish reporting dates for individual lessees different from those specified in this subpart in order to provide more effective administration. Lessees will be notified of any change in their reporting period.

(4) Transportation allowances must be reported as a separate line item on

Form MMS-2014, unless MMS approves a different reporting procedure.

(d) *Interest assessments for incorrect or late reports and for failure to report.* (1) If a lessee deducts a transportation allowance on its Form MMS-2014 without complying with the requirements of this section, the lessee shall pay interest only on the amount of such deduction until the requirements of this section are complied with. The lessee also shall repay the amount of any allowance which is disallowed by this section.

(2) If a lessee erroneously reports a transportation allowance which results in an underpayment of royalties, interest shall be paid on the amount of that underpayment.

(3) Interest required to be paid by this section shall be determined in accordance with 30 CFR 218.54.

(e) *Adjustments.* (1) If the actual transportation allowance is less than the amount the lessee has taken on Form MMS-2014 for each month during the allowance form reporting period, the lessee shall be required to pay additional royalties due plus interest computed under 30 CFR 218.54, retroactive to the first day of the first month the lessee is authorized to deduct a transportation allowance. If the actual transportation allowance is greater than the amount the lessee has taken on Form MMS-2014 for each month during the allowance form reporting period, the lessee shall be entitled to a credit without interest.

(2) For lessees transporting production from Indian leases, the lessee must submit a corrected Form MMS-2014 to reflect actual costs, together with any payment, in accordance with instructions provided by MMS.

(f) *Actual or theoretical losses.* Notwithstanding any other provisions of this subpart, for other than arm's-length contracts, no cost shall be allowed for oil transportation which results from payments (either volumetric or for value) for actual or theoretical losses. This section does not apply when the transportation allowance is based upon a FERC or State regulatory agency approved tariff.

(g) *Other transportation cost determinations.* The provisions of this section

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shall apply to determine transportation costs when establishing value using a netback valuation procedure or any other procedure that requires deduction of transportation costs.

Subpart C—Federal Oil

SOURCE: 65 FR 14088, Mar. 15, 2000, unless otherwise noted.

§ 206.100 What is the purpose of this subpart?

(a) This subpart applies to all oil produced from Federal oil and gas leases onshore and on the Outer Continental Shelf (OCS). It explains how you as a lessee must calculate the value of production for royalty purposes consistent with the mineral leasing laws, other applicable laws, and lease terms.

(b) If you are a designee and if you dispose of production on behalf of a lessee, the terms “you” and “your” in this subpart refer to you and not to the lessee. In this circumstance, you must determine and report royalty value for the lessee’s oil by applying the rules in this subpart to your disposition of the lessee’s oil.

(c) If you are a designee and only report for a lessee, and do not dispose of the lessee’s production, references to “you” and “your” in this subpart refer to the lessee and not the designee. In this circumstance, you as a designee must determine and report royalty value for the lessee’s oil by applying the rules in this subpart to the lessee’s disposition of its oil.

(d) If the regulations in this subpart are inconsistent with:

- (1) A Federal statute;
- (2) A settlement agreement between the United States and a lessee resulting from administrative or judicial litigation;
- (3) A written agreement between the lessee and the MMS Director establishing a method to determine the value of production from any lease that MMS expects at least would approximate the value established under this subpart; or
- (4) An express provision of an oil and gas lease subject to this subpart, then the statute, settlement agreement, written agreement, or lease provision

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will govern to the extent of the inconsistency.

(e) MMS may audit and adjust all royalty payments.

§ 206.101 What definitions apply to this subpart?

The following definitions apply to this subpart:

Affiliate means a person who controls, is controlled by, or is under common control with another person. For purposes of this subpart:

(1) Ownership or common ownership of more than 50 percent of the voting securities, or instruments of ownership, or other forms of ownership, of another person constitutes control. Ownership of less than 10 percent constitutes a presumption of noncontrol that MMS may rebut.

(2) If there is ownership or common ownership of between 10 and 50 percent of the voting securities or instruments of ownership, or other forms of ownership, of another person, MMS will consider the following factors in determining whether there is control under the circumstances of a particular case:

(i) The extent to which there are common officers or directors;

(ii) With respect to the voting securities, or instruments of ownership, or other forms of ownership: the percentage of ownership or common ownership, the relative percentage of ownership or common ownership compared to the percentage(s) of ownership by other persons, whether a person is the greatest single owner, or whether there is an opposing voting bloc of greater ownership;

(iii) Operation of a lease, plant, or other facility;

(iv) The extent of participation by other owners in operations and day-to-day management of a lease, plant, or other facility; and

(v) Other evidence of power to exercise control over or common control with another person.

(3) Regardless of any percentage of ownership or common ownership, relatives, either by blood or marriage, are affiliates.

ANS means Alaska North Slope (ANS).

Area means a geographic region at least as large as the limits of an oil